Testimony of
James B. Lockhart III
Deputy Commissioner of Social Security
Hearing before the Special Committee on Aging
United States Senate
July 29, 2003

Mr. Chairman, Members of the Committee, thank you for inviting me here today to discuss GAO's report entitled "Social Security Reform: Analysis of a Trust Fund Exhaustion Scenario." I would like to take this opportunity to commend the Chairman and the Committee for holding this hearing, and keeping the important issue of Social Security reform before the public. We at Social Security think it is an extremely important issue. Commissioner Jo Anne Barnhart has made achieving sustainable solvency one of Social Security's four major strategic goals.

I would like to begin by discussing the current and future financial status of the Social Security program. The figures I will cite are taken from the recent 2003 Annual Report of the Board of Trustees and will therefore differ somewhat from the figures contained in the GAO report, which used data from the 2001 Trustees Report. However, the qualitative conclusions drawn from both are the same: that the Social Security program as currently financed is unsustainable for the long term.

I must place some stress on the phrase "long term." Today Social Security is running surpluses, and I want to make it clear that the benefits of current retirees and those nearing retirement are safe. Social Security's future financing shortfalls or changes proposed to address those shortfalls will not result in benefit reductions for retirees or near retirees.

Social Security continues to be one of the most successful government programs. Last year SSA paid over $450 billion in benefits to 46 million retirees, survivors, and disabled individuals. Social Security is much more than a retirement program. Thirty percent of our beneficiaries are disabled or survivors -- widows, widowers and children. About 154 million American workers paid Social Security taxes last year. They, and the millions joining the system every year, are relying on Social Security for a major portion of their future financial security.

Moreover, the combined old age and disability trust funds are growing; last year the funds grew to $1.4 trillion—an increase of 14 percent over the prior year. It should be noted, however, that half of that growth was from bonds issued to the fund to pay interest on existing assets.

The Trustees point out that pressure on the trust funds will begin in 2008, when the first baby boomers reach early retirement age and Social Security tax surpluses begin to decline. Beginning in 2018 the trust funds are projected to begin paying out more in benefits than is collected in taxes. At that time the funds will begin redeeming their assets, consisting of government bonds. By 2042, it is projected that all of the Treasury bonds that make up the trust fund assets will have been cashed in, and the Social Security trust fund assets will be exhausted. Over the long term, as the Trustees' Report says, the trust funds would be capable of paying less than 73 percent of scheduled benefits.

The trust funds would need the equivalent of an additional $3.5 trillion today to be able to pay all scheduled benefits for the next 75 years. $3.5 trillion is the present value of the Social Security program's unfunded benefit obligations over the next 75 years. That means that a lump sum of $3.5 trillion today, earning interest at the Treasury bond rate, could be drawn down to pay annual revenue shortfalls over the next 75 years. This $3.5 trillion is a figure roughly equal to the total public portion of the national debt. This measure of unfunded benefit obligations is up $200 billion over last year and $600 billion over 2000. Absent any action to address this situation, this steady growth in the shortfall will continue, year after year.

Traditionally, the Trustees have measured the long-term financial health of the Social Security system by evaluating the system's operations over a 75 year period. However, to achieve <u>sustainable</u> solvency, which the Trustees have defined as not only meeting the 75 year test of solvency but also assuring that at the end of that 75 year period the trust fund is stable or rising – that is, to make Social Security solvent permanently – the trust funds would need an additional present value $10.5 trillion today. Absent any action the shortfall will continue to grow at a compounding rate.

If this remaining $10.5 trillion shortfall were divided up among current workers – that is, if they decided to leave to future generations a program free of unfunded obligations – it would equal over $99,000 per average family of 1.5 workers. For the average family, Social Security's unfunded obligations almost equal the family's net worth of $107,000. Even if spread among future workers not yet entered into the program, the price for making the current Social Security program sustainable is large.

At your request, Mr. Chairman, the GAO has today issued a report detailing what may occur in the event that the trust fund exhaustion date is reached without any Congressional action being taken. The scenario GAO analyzed—a proportional reduction in benefits—is a very possible outcome in such a situation.

At the point of trust fund exhaustion, in 2042, tax income would cover only 73 percent of scheduled benefits, which means a 27 percent across the board reduction in scheduled benefits. Benefits would continue to decrease thereafter and by 2077, there would be a 35 percent reduction in scheduled benefits. Younger workers would be particularly hurt in a trust fund exhaustion scenario, as they would spend much or all of their retirement years in a post-trust fund exhaustion world.

It would be very hard to explain that to the younger generation. My 26 year old son who is here today, and who will reach the then normal retirement age of 67 in 2044, after paying into Social Security for well over 40 years will have his scheduled benefits drastically cut and every year in retirement they would continue to be cut. In contrast, based on life expectancy, we leading edge baby boomers will not see a benefit cut.

Congress has never allowed the finances of the Social Security program to reach the point that full promised benefits could not be paid, and I would not expect it to do so in the future. If benefits were not reduced and only tax increases were used to address solvency, the payroll tax rate would have to increase from the current 12.4% to 15.9% in 2043 and would continue to increase each year thereafter rising in 2077 to a rate of 18.9% of covered wages, more than 50 percent higher than it is today. The GAO report only reinforces the position that action to strengthen Social Security should be taken sooner rather than later to assure that the events outlined in the report never take place.

The President has pledged that trust fund exhaustion will never take place. Social Security's insolvency must be prevented and it will be prevented, through the bipartisan cooperation of Congress, the Administration, and the American people.

As the Trustees said in their Annual Report, "The sooner adjustments are made, the smaller and less abrupt they will have to be." Changes can be phased in more gradually, reducing the need for any sudden and severe impact on American workers and their families. The effect upon each individual can be decreased through early action because the cost of fixing Social Security can be more evenly spread among generations of American workers. For example, the changes enacted for the retirement age in 1983 were phased in over many years; individuals reaching normal retirement this year were the first to have their retirement age increased. For this year's retirees the age is 65 years and 2 months.

Early action will also allow current workers plenty of time to properly plan for their retirement. And finally, the sooner action is taken, the sooner confidence can be restored to the Social Security program and the sooner the burdens of future economic and retirement uncertainties faced by the American public can be relieved.

The goal of strengthening Social Security is not simply to make the Social Security program solvent at the end of the 75 year long-range period but rather to achieve sustainable solvency, that is, to <u>maintain</u> solvency beyond the 75-year period. Under the scenario developed in the GAO report, sustainable solvency, by definition, would be achieved. Although this scenario--a large and abrupt benefit cut beginning in 2042, followed by continuing benefit reductions--would achieve sustainable solvency, I think we can agree that this is not a desirable outcome.

Clearly, achieving sustainable solvency will be no easy task. However, delay only makes the task more difficult. It is not suggested that taxes be increased or benefits cut, especially for retirees or near retirees, but, solely as an illustration of the costs involved to reach solvency just through 2077, there would need to be either an immediate 15 percent increase in payroll taxes or a 13 percent reduction in benefits. By 2018, there would need to be a 22 percent increase in payroll taxes or a 16 percent reduction in benefits. And by 2042, if nothing is done, payroll taxes would have to be increased by 46 percent, or benefits cut by nearly one-third.

The unattractiveness of relying exclusively on tax increases and benefit reduction to bring Social Security to balance, has led Republicans and Democrats to look for additional options. A number of them, including a majority of each of the last two presidential advisory commissions, as well as President Bush himself, have proposed that this be accomplished through Social Security personal accounts.

One of the Social Security Administration's key roles is for our actuaries to provide a non-partisan costing of any reform proposals. To that end, they reviewed all three of President Bush's Commission to Strengthen Social Security's proposals and have reviewed a number of plans introduced or developed by both Democratic and Republican Members of the House and Senate. These proposals contain a wide range of provisions; many include personal retirement accounts, and the plans use a variety of means to restore Social Security to 75-year solvency, including changes to benefit growth, the retirement age, cost of living adjustments, and inclusions of transfers of general tax revenue to Social Security. Some of these proposals would ultimately have significantly less costs to the trust funds and to general revenues than the current system in order to offer the same projected total benefit levels.

With bipartisan commitment, informed discussion, creative thinking, and timely legislative action, we will ensure that Social Security continues to protect future generations.

As we all know, this century will see a rapidly aging America, which will bring about changes in many areas of national life, including the Social Security program. Just in the next 30 years the number of Americans aged 65 and older will double. Lower birth rates and increased life expectancies have reduced the ratio of workers to beneficiaries from over 8-to-1 in 1955 to around 3-to-1 today. By 2031 there will be only around 2 workers supporting each Social Security beneficiary.

In March of this year, Social Security's Board of Trustees presented its annual report to President Bush personally. At this meeting, the President reiterated his support for action to strengthen Social Security, saying;

> "…the Trustees confirmed that benefits for today's seniors are safe and secure. Promises made can and will be kept. The Trustees also

> once again have delivered a sobering message—Social Security, in its present form, is unsustainable for the long term. I share the Trustees' view that we need to explore new ways to ensure that Social Security remains strong and financially secure for America's children and grandchildren.
>
> “I am encouraged by the unprecedented level of bipartisan interest in Social Security modernization. Many comprehensive proposals have been put forward to strengthen Social Security for the long term. Although these proposals differ in details, they are consistent in showing that if we give workers the opportunity to invest a portion of their wages in personal accounts, Social Security will be able to offer higher benefits than would otherwise be the case.
>
> “…I hope that Members of Congress will join with the Social Security Administration and other interested parties in a national dialogue about how best to strengthen and protect Social Security. I look forward to working with Congress to see that Social Security remains sound and strong for today's and tomorrow's retirees.”

This hearing, I hope, will be part of that process of working together to fulfill our obligations to the Social Security program and the hundreds of millions of Americans it serves, today and in the future. The Social Security Administration will continue to work with this committee, other Members of Congress and outside groups to build this national dialogue into a bipartisan consensus on how to strengthen Social Security for future generations.

There is no other Federal program that impacts the lives of so many Americans. And as important as the program is today, it will become even more important in the next few decades, when today's boomers become tomorrow's aged. We must find a way to financially provide for these older Americans without unduly burdening succeeding generations.

In conclusion, I would like to just quote the old seafaring wisdom that I found applicable in my Navy days, which is "the world isn't interested in the storms you encountered, but whether or not you brought in the ship."

I believe that this will be the true test of our own work. Storms of controversy often surround the issue of how to provide retirement security. My son's and future generations will care primarily that we have been able to protect and strengthen the Social Security program so that it can remain a safe harbor for them and their children.

Mr. Chairman, thank you again for inviting me to discuss the GAO report and the future of Social Security. I look forward to working with you, and other Members of Congress and the Administration to reach a bipartisan consensus on how best to reform Social Security for the future.